Natural Catastrophe Risk: Creating a Comprehensive National Plan

This paper contains various perspectives on preparing the United States of America and the various states for natural catastrophes. The various perspectives are presented to demonstrate the diversity of views on this important topic.

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Introduction

Natural disasters take a heavy financial and emotional toll on Americans every year. Following Hurricane Katrina, the Government Accountability Office (GAO) issued a report that concluded the United States is not well prepared to handle large natural disasters; this includes the initial emergency response as well as the financial aftermath. Americans need to be better prepared for natural disasters both logistically and financially; insurance has an important role to play in this equation.

The National Association of Insurance Commissioners (NAIC) has actively examined approaches to insuring against natural disasters for the last four decades. In fact, Volume 1 of the 1973 NAIC Proceedings cites a report from the Availability of Essential Insurance (D2) Subcommittee that recommends a five-step program to address this problem. Interestingly, step five is, "The Federal Government, in cooperation with the insurance industry and the NAIC, study and develop a mechanism that would provide additional capacity for catastrophe insurance and would allow for the accumulation of funds from which catastrophe losses could be paid without having those funds depleted by Federal income tax in loss-free years."

The Property and Casualty (C) Committee has developed a possible model system for implementing this concept of tax deferred catastrophe reserves, and has advocated legislative changes to the Federal Tax Law since 2000. More recently, the (C) Committee re-constituted the Catastrophe Reserve Subgroup to revisit the model system and to recommend possible changes.

The 1973 NAIC report also precipitated continued discussions of developing an additional security mechanism to insure against national catastrophes. In February 2005, the Catastrophe Insurance Working Group (CIWG) of the NAIC's Property Casualty (C) Committee held an interim meeting in Orlando, Florida to consider the US insurance industry's catastrophe readiness. More importantly, the committee also began to develop a comprehensive national plan to manage catastrophic risk, and utilized the guiding principles first established by the NAIC in 1999 (see Appendix I). The CIWG report summarized the work to date, and highlighted one important fact: a truly comprehensive solution will not only require a commitment of resources from the regulatory community and the insurance industry, but also from the federal, state and local governments.

The insurance industry cannot be expected to provide comprehensive catastrophe coverage without adequate financial backstops for the most extreme events. This report outlines steps that regulators believe must be taken to accomplish the dual purpose of providing a comprehensive plan that protects the public, while simultaneously providing assurances to the insurance industry should "the big one" occur. Another issue is that even now, some of the nation's most exposed residential customers are experiencing difficulties with the availability and affordability of insurance products -- future catastrophic losses will only exacerbate this problem. As would be expected, regulators and the insurance industry do not agree on how best to resolve these issues; these divergent viewpoints are noted throughout the report.

Background

There have been several recent natural disasters that have captured the nation's attention. The following examples highlight the estimated insured losses using 2007 dollars. In 1989, Hurricane Hugo caused $7.2 billion in insured losses to South Carolina. In 1992, Hurricane Andrew devastated Florida resulting in $23.56 billion in insured losses. In 1994 the Northridge Earthquake in California cost insurers a total of $17.9 billion. In 2004, four major hurricanes reached landfall in the Gulf Coast States which included Hurricane Charlie ($8.45 billion) followed by Ivan ($8.0 billion), Frances ($5.23 billion) and Jeanne ($4.17 billion). The most costly hurricane ever was Katrina in 2005 with insured loss estimates in excess of $42 billion. Two other hurricanes in 2005—Wilma and Rita – caused $7.64 billion and nearly $5 billion in damage respectively. It is not simply the frequency of large storms that created financial problems for the U.S. insurance industry --- all seven of these storms are now included in the list of top ten costliest storms in United States history.

With a few exceptions, all of the insured losses related to wind-damage have been handled by the insurance industry. The uninsured losses associated with these events have been paid by the states and the federal government using taxpayer funds.

Despite relatively quiet storm seasons in 2006 and 2007, these catastrophic losses have public policymakers concerned about the industry's ability to continue to handle these catastrophic losses, as well as to continue to have the capacity to handle the next major natural disaster.

The Potential for a Mega-Disaster

While Hurricane Katrina was devastating, catastrophe modelers have identified a number of possible natural disasters that would dwarf the damages caused by this event. These are not fantastic scenarios, but instead, have already occurred in our nation's history – just not at current exposures, and structure values. The 1906 San Francisco earthquake would create damage of $400 billion with over $200 billion in uninsured property losses if it had occurred today; a repeat of the 1900 Galveston hurricane would cause $36 billion in possible damages; a repeat of the 1938 Category 3 hurricane that reached landfall in the Northeast would cause damage exceeding $300 billion; a repeat of the series of earthquakes that struck the New Madrid Fault in 1811 and 1812 would cause potential economic damage of up to $275 billion with insured losses reaching $100 billion. All of these scenarios have occurred in the past, and could potentially occur again in the future. The current structure to handle catastrophe losses may be overwhelmed by an event of this magnitude.

The Insurance Industry and Regulators Must Take Additional Measures

Many residential properties are overly exposed to natural disasters thus increasing the risk of damage. Whether it is through regional planning, mitigations measures, or more substantive building codes, cost-effective steps must be taken to reduce exposure to catastrophic losses. Insurers should provide incentives for consumers by providing credits for homes built to comply with effective building codes or for existing homes that are retrofitted to have a greater capacity to withstand damage.

Policymakers should also review how insurance benefits are delivered to the public. Requiring a person to buy multiple insurance contracts to cover their homes and belongings clearly is not efficient, does not meet consumer needs, and often creates confusion during the claims settlement process. Determining whether a loss is due to wind or water is not just problematic, it is time-consuming and stressful to the public – especially if one peril is covered, and the other (often flood) is not. Policyholders simply want to buy one comprehensive policy that meets their needs. The insurance industry, working with the regulatory community, needs to find a better way to meet these expectations.

Past Congressional Efforts to Address Catastrophe Losses

The United States Congress has considered many proposals to address catastrophic loss. In fact, since the early 1970s, only three Congresses (the 98th through the 100th—1983 to 1988) have failed to consider significant natural disaster legislation. Nevertheless, the only federal program currently in operation is the National Flood Insurance Program (NFIP), which is under Federal Emergency Management Agency (FEMA) jurisdiction. The GAO heavily criticized FEMA for its inadequate response to Hurricane Katrina, and the financial performance of the program has been checkered.

On November 18, 2005, Congress voted to significantly increase FEMA's borrowing authority to pay flood insurance claims, just days after the agency was forced to halt payments due to insufficient funds following the aftermath of Hurricane Katrina. The House by unanimous consent agreed to changes made by the Senate to H.R. 4133 that would temporarily raise FEMA's borrowing authority for the NFIP to $18.5 billion. The Senate passed the bill earlier in the day after increasing the borrowing authority in the previous House version. In addition, on the same day the House Financial Services Committee voted to increase the borrowing authority for the federal flood insurance program to $22 billion specifically to help cover claims from Hurricane Katrina and other recent disasters.

The 110th Congress has been particularly active in considering legislation pertaining to insurance and natural disasters. Some of the activity stems from the Congressional need to reauthorize the NFIP. However, a significant amount of legislation is unrelated to the NFIP. Currently, there are seven bills pending in the House of Representatives and seven bills pending in the Senate (see Appendix II). Most of the bills would require federal involvement in disasters apart from the NFIP. These bills range from plans that would create study commissions to creating tax deferred savings accounts for homeowners. Some bills would also allow for the creation of tax deferred pre-event industry reserves, while another would utilize the Treasury as lender of last resort to provide liquidity to state or regional funds (H.R. 3355, introduced by Rep. Klein). Another bill would remove hurricane risk from the private market and offer the coverage through the NFIP (HR 920, introduced by Rep. Taylor).

H.R. 3355, the Homeowners Defense Act of 2007, is notable because it passed the US House of Representatives on November 8, 2007. This marks the first significant insurance legislation for natural catastrophes since the Legislature founded the National Flood Insurance Program in 1968. The following summary of the bill was prepared by the Congressional Research Service:

> **Homeowners' Defense Act of 2007 - Declares that the purpose of this Act is to provide federal support for state-sponsored insurance programs to: (1) help homeowners prepare for and recover from damages caused by natural catastrophes; and (2) promote the use of private market capital as a means to insure against such catastrophes.**
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> **Title I: National Catastrophe Risk Consortium - (Sec. 101) Establishes the National Catastrophe Risk Consortium as a nonprofit, nonfederal entity to: (1) inventory catastrophe risk obligations held by state reinsurance funds, and state residual insurance market entities; (2) issue, on a conduit basis, securities and other financial instruments linked to catastrophe risks insured or reinsured through Consortium members; (3) act as a centralized repository of state risk information accessible by private-market participants seeking to participate in either such financial instruments or certain reinsurance contracts; and (4) perform research and analysis that encourages standardization of the risk-linked securities market.**
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> **Makes eligible to join the Consortium any: (1) state that has established a reinsurance fund or has authorized operation of a state residual insurance market entity; or (2) state-sponsored provider of natural catastrophe insurance.**
>
> **(Sec. 107) Shields the federal government and the Consortium from liability arising from Consortium actions. Requires participating states to retain all catastrophe risk until completion of specified transactions.**
>
> **(Sec. 108) Authorizes appropriations for FY2008-FY2013.**
>
> **Title II: National Homeowners' Insurance Stabilization Program - (Sec. 201) Instructs the Secretary of the Treasury to implement a program to make liquidity loans and catastrophic loans to qualified reinsurance programs to: (1) ensure their solvency; (2) improve the availability and affordability of homeowners' insurance; (3) encourage risk transfer to the private capital and reinsurance markets; and (4) spread the risk of catastrophic financial loss resulting from natural disasters and catastrophic events.**
>
> **(Sec. 202) Prescribes terms and conditions for liquidity loans and catastrophic loans for qualified reinsurance programs. Authorizes the Secretary to enter into loan contracts.**
>
> **Requires as one prerequisite for such a loan to a qualified reinsurance program that before the loan is made the state or regional reinsurance program enter into an agreement with the Secretary that the state will not use federal funds of any kind or from any federal source (including any disaster or other financial assistance, loan proceeds, and any other assistance or subsidy) to repay the loan.**
>
> **Cites circumstances under which the Secretary is required to make loans upon request of a qualified reinsurance program.**
>
> **Limits the use of such loans solely to providing reinsurance or retrocessional coverage to underlying primary insurers or reinsurers for losses arising from specified personal residential lines of insurance.**
>
> **(Sec. 204) Authorizes the Secretary to establish a fee collection program to implement this Act.**
>
> **Instructs the Secretary to require full repayment of all loans made under this Act.**

Title III: Reinsurance Coverage for Qualified Reinsurance Programs - (Sec. 301) Authorizes the Secretary to make contracts for reinsurance coverage under this title available for purchase only by qualified reinsurance programs.

(Sec. 302) Declares that contracts for reinsurance coverage made available under this title: (1) shall not displace or compete with the private insurance or reinsurance markets or the capital market; (2) shall minimize the administrative costs of the federal government; and (3) shall provide coverage based solely on insured losses covered by the qualified reinsurance program purchasing the contract.

(Sec. 303) Specifies terms and conditions of qualified reinsurance programs, including: (1) a minimum attachment point; and (2) 90% coverage of insured losses in excess of retained losses.

(Sec. 304) Sets the maximum aggregate potential federal liability for payment of claims under all reinsurance contracts sold in any single year at $200 billion, or such lesser amount as the Secretary determines based on review of the reinsurance market.

Limits the authority of the Secretary to enter into reinsurance contracts for any fiscal year to the extent or in such amounts as are or have been provided in appropriation Acts for that fiscal year.

(Sec. 305) Establishes in the Treasury the Federal Natural Catastrophe Reinsurance Fund, to be credited with amounts received annually from the sale of reinsurance contracts, appropriations, and any amounts earned on investments.

Authorizes the Secretary to invest in U.S. bonds any amounts in the Fund in excess of current needs.

Title IV: General Provisions - (Sec. 401) Prescribes criteria for a qualified reinsurance program under this Act.

Directs the Secretary to establish procedures for state and regional reinsurance programs and certain state residual insurance market entities to apply for certification (and recertification) as qualified reinsurance programs.

Requires each qualified reinsurance program (except any existing state residual insurance market entity, or state-sponsored provider of natural catastrophe insurance, deemed to be a qualified reinsurance program during an initial five-year transition period) to: (1) maintain risk-based capital in accordance with requirements established by the Secretary, in consultation with the National Association of Insurance Commissioners (NAIC) and consistent with the NAIC Risk-Based Capital Model Act; and (2) take into consideration asset risk, credit risk, underwriting risk, and other relevant risks.

Directs the Secretary to recognize and give credit for the ability of any qualified reinsurance program to access capital through the liquidity loan program (established under title II of this Act) to the extent that such program is deficient in complying with any aspect of risk-based capital requirements.

Requires the Secretary to increase the credit recognized and given for a qualified reinsurance program by an amount equal to the losses paid by the program as a result of a catastrophe.

(Sec. 402) Directs the Secretary to study, on an expedited basis, the need for and impact of expanding the programs established by this Act to apply to insured losses of qualified reinsurance programs for losses arising from all commercial insurance policies covering properties composed predominantly of residential rental units (commercial residential lines of insurance).

Requires the Secretary, to the extent a need to expand is determined, and that such expansion will be effective in increasing insurance capacity for the commercial residential insurance market, to: (1) apply the provisions of this Act, as appropriate, to any such insured losses of a qualified reinsurance program; and (2) provide restrictions, limitations, or conditions with respect to the programs under this Act that the Secretary deems appropriate, based on the study.

After a review by the Catastrophe Insurance Working Group, followed by a review and approval vote of the Property and Casualty (C) committee, the NAIC endorsed the bill as being consistent with the guiding principles established by the NAIC in 1999 (see Appendix III).

Alternative Solutions to Managing Catastrophic Risks outside the US

The US and other nations with developed economies have enacted a variety of programs to manage the economic consequences of catastrophic events. The programs differ in their structure based on underlying premises of the nature of the risk. Consequently the roles of the private insurance market and government entities vary considerably across programs. The GAO report "U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks," GAO-05-199 published in February 2005, provides a thorough description of these various approaches.

There is considerable public policy debate as to whether a specific type of natural catastrophe is an insurable risk. In 1968, the US Congress decided that flood was not an insurable risk, which resulted in the creation of the National Flood Insurance Program. Interestingly, other countries *do* consider flood an insurable risk. Indeed, both France and Spain have created risk pools that feature a state assumption of risk on an unlimited basis for specific natural catastrophes.

On the other hand, many natural catastrophes are considered insurable; government is used sparingly to supplement the private sector mechanism in these situations. Perhaps the most common tool available to the private sector is the ability to set aside reserves on a tax-deferred basis to pay for losses from a natural catastrophe. While differences do exist in how these reserves are structured and monitored, they are common throughout the world.

A recent International Accounting Standard ruling (accounting guidance that is followed by most of the rest of the world with the exception of the US) would have eliminated this reserving mechanism; however, virtually all European nations, along with a number of other jurisdictions chose not to adopt this new rule. The US does not currently allow insurers the option of establishing tax-deferred pre-event reserves to fund catastrophe losses; although a number of variants of a tax-deferred reserve have been developed since Hurricane Andrew in 1992.

The creation of "risk pools" is another tool utilized to pay for catastrophic losses. Typically these pools are managed by the government, and funded by the private sector. As an example, in Switzerland coverage for all natural catastrophes, with the exception of earthquakes, is mandated in property insurance policies. Private insurers, as well as state-owned entities, pool these risks and determine an average actuarial rate.

A National Residential Program for Insuring Catastrophic Risk

In February 2005, the Catastrophe Insurance Working Group (CIWG) of the Property Casualty (C) Committee of the National Association of Insurance Commissioners (NAIC) met in Orlando to evaluate the state of catastrophe readiness in the US, and to initiate the development of a comprehensive national plan for managing catastrophic risk.

The Committee drafted a white paper, and presented this at the working group's meeting during the NAIC 2005 Spring National Meeting. Other regulators were given an opportunity to provide comments and feedback to the working group at this meeting. Based on this feedback, the working group decided it was appropriate to hold a half day mini-summit to hear from all interested parties at the following working group meeting in September 2005. Due to hurricane Katrina, the NAIC 2005 Fall National Meeting, as well as the mini-summit, was cancelled.

During the same time, a number of State Insurance Commissioners (notably commissioners from California, Florida, Illinois and New York) began work on a proposal that would help ensure a stable, long-term solution to the catastrophic risk problem. The state commissioners held a summit in November 2005 and offered a framework for this plan; a number of insurance and catastrophe experts were in attendance, provided information, and created a dialog on this important subject. The framework developed by the commissioners parallels many of the concepts developed by the CIWG.

The draft document has been revised numerous times to reflect consensus. On some issues, regulators could not achieve a consensus.

The current plan is based on several guiding principles:

- A national program should promote personal responsibility among policyholders;
- A national program should support reasonable building codes, land use development plans, and other mitigation tools;
- A national program should maximize the risk-bearing capacity of the private markets, and;
- A national plan should provide quantifiable risk management by the federal government.

The current plan envisions two layers of risk-bearing capacity before federal government resources are utilized. The Federal government, represented in the third layer, would become financially involved if the catastrophic losses exceed the capacity of the first two layers.

The First Layer: Shaping the Risk, Enhancing Capacity, and the Insurance Contract

Developing a Comprehensive Mitigation Program

Mitigation can produce profound benefits by reducing insured losses from a catastrophic event. Consumers should be educated about how specific mitigation efforts can increase property values and give consumers greater security in knowing their property is better protected to withstand the forces of nature. State and local governments, along with the insurance, construction, real estate and mortgage industries can be utilized to educate both current homeowners and prospective homebuyers.

Mitigation policies should provide property owners with meaningful mechanisms for effective mitigation measures. These mechanisms could include such things as low interest loans, grants and premium credits to upgrade existing properties, strengthen and enforce building codes for new properties, and to improve land use regulations in the development and redevelopment of communities located within hazard-prone areas. Policyholders should be further encouraged to invest in effective mitigation through a modification of the US Tax Code to allow federal income tax credits for investments that better protect property from natural disaster losses.

At the core of the proposed plan is the need for a comprehensive program to establish and implement effective mitigation and land use plans among the states. Clearly, this is not a “one-size fits all” endeavor; different natural catastrophes require different mitigation considerations. Therefore, the implementation of these standards is best reserved for state governments; mitigating for hurricanes in Florida requires a different set of techniques than mitigating for flood along the Mississippi or Platte Rivers. Other unique examples include insuring against tornadoes in Oklahoma, or earthquakes in Missouri.

The NFIP has determined that repetitive flood claims represent an inordinately high percentage of their overall claims. The recent Florida hurricanes provided stark evidence that homes built or retrofitted to modern building codes withstand catastrophic events, while those built to lesser codes are more likely to structurally fail. Most recently, some media reports have suggested that 40 – 75% of the wind damage from hurricane Katrina could have been avoided if homes had been built to modern building codes.

Despite outreach by the Institute for Business and Home Safety (IBHS, www.DisasterSafety.org) and the Federal Alliance for Safe Homes (FLASH, www.Flash.org), one of the primary challenges facing a long-term solution is to incorporate this information into the economic decision-making processes. A competitive market requires an informed consumer and consumers need to be made aware of the options available to them when building or buying a home.

While efforts to make the benefits of mitigation clear in the insurance contract are important, it is also critical to make the cost/benefit analysis part of the property owners’ decision. Just as consumers now demand airbags and side-impact curtains in their automobiles, the ability to quantify the disaster resistance of a home should be integral to the decision making process. In one domestic example, a program in Oklahoma (see www.fema.gov/mitigationbp/brief.do?mitssId=843 for more information) has been promoting the benefits of having a safe room for shelter from tornados in Tulsa. This program has been quite successful; to the point where homes in the area without a safe room have become less marketable. Japan has an even more ambitious initiative that involves rating structures for earthquake resistance (see Appendix IV for an overview of the program).

More recently, Florida introduced a home grading and mitigation program for residential properties, the My Safe Florida Home program. At a CIWG meeting, representatives of the program presented an overview of the program to the working group. CIWG members agreed about the importance of a comprehensive mitigation program.

Creating Meaningful, Forward Looking Reserves

To further expand the capital base available for underwriting property risk, insurance companies should be allowed to set aside, on an objective formulaic basis, some portion of the premiums paid by the policyholders into a reserve for future catastrophic events. This ability will require a modification of the US Tax Code to allow insurers to establish these pre-event reserves on a tax-deferred basis.

Through the CIWG chaired by Florida, the NAIC developed a model plan in 2000. This plan is still pending, as it will take political initiative by the US Congress to amend the Internal Revenue Service Code. Before becoming governor of his state, Rep. Jindal (LA) offered a reserving plan bill during the 110th Congress. This bill, H.R.164, offers amendments to the Tax Code that would allow insurers to voluntarily create pre-event reserves on a tax-deferred basis subject to a cap.

While the mechanics of the bill are different than the NAIC proposal, they share many of the same features. Reserves are calculated using a specific formula based on the amount of business an insurer writes in the lines of insurance potentially affected by a catastrophic event. This formula minimizes the opportunity for insurance companies to inflate reserves to defer federal taxes. When the cap is reached additional reserve contributions are fully taxed. Similarly, if an insurer leaves the business, the accumulated reserves are also fully taxed as income. Additionally, both Jindal's bill and the NAIC model plan have a 20-year phase-in period to accumulate maximum reserves. Use of the reserves is limited to events officially declared a disaster.

The NAIC proposal is state specific with regard to the reserve calculation, while the Jindal bill is based on an aggregate line of business calculation. The NAIC proposal has an aggregate industry dollar cap; H.R. 164 does not. Among the CIWG members and most industry interested parties, there was general but not unanimous agreement and support for the need to establish these types of reserves.

Enhancing the Insurance Contract

Policyholders are not generally sophisticated consumers of insurance products. However, policyholders do have an expectation that their residential insurance policy will, net of a deductible, indemnify them in the event of damage to their home, regardless of the cause. To that end, the current insurance contracts frequently deliver an unpleasant surprise – policyholders may find their policy does not cover a specific peril *after* a catastrophic event.

During the development of the current NAIC plan, some members of the working group offered an alternative suggestion: offer a policy that provides coverage for all perils. There is a caveat to this "all perils" approach; specific risks would still be excluded including: ordinances or laws; power failures; property neglect; acts of war; nuclear hazards; intentional losses; and governmental actions. Thus, natural disaster coverage would be offered in the basic property insurance contract; regardless of whether it is financed by the private or public sector.

Under this concept, flood insurance would be included. The consumer would have only one insurance company and one claims adjuster in the event of a loss. However, the risk of flood would remain with the NFIP with the NFIP acting as a reinsurance program that would provide coverage to insurers for flood losses on a first dollar basis, minus the applicable deductible. Premiums for flood insurance coverage would be risk-based, and insurers would not be expected to subsidize flood insurance losses.

Other members of the working group, and most participating interested parties, were opposed to the mandatory all perils concept due to concerns about the reduction of consumer choice. Some regulators and industry representatives believed that including flood in the basic policy would create additional risks for the insurance company as the insurance companies would be required to pay the initial flood claims, and wait for reimbursement from the NFIP.

As a compromise, the working group agreed that to meet the expectations of consumers, the policyholder should be given a mandatory offer of an all-perils policy. If the consumer does not feel the need to insure against a specific risk at the price being offered by the insurer, the consumer can then decide which coverage(s) they wish to purchase and which they do not wish to purchase. Exclusions and coverage limitations should be disclosed to the consumer and explained to the consumer prior to the purchase of the policy. Subtleties of whether flooding was caused by wind-driven water, storm surge or rain-induced flooding should be eliminated to alleviate any coverage confusion. Policyholders should also be required to acknowledge the impact of changes to coverage on the policies they purchase. At some point in the future, consideration may be given to changing the mandatory offer feature to a mandatory coverage of these perils.

However, the working group did feel that for those properties financed with a federally guaranteed mortgage (whether the guarantee is explicit or implicit), natural disaster coverage should be mandatory for those properties located in areas of moderate to high risk of catastrophic events. This may be expressed by the prevalence of the risk for a specific type of peril. For example, it could be mandatory for a 1 in 250 year flood event or earthquake event, or a 1 in 100 year catastrophic hurricane. Individuals with federally guaranteed mortgages are already receiving a sizeable subsidy from the US government, so it is fair to require these individuals to purchase adequate insurance. Ultimately, it is the American taxpayers who will pay for inadequate coverage of catastrophic natural disasters.

The policy could contain a fixed dollar deductible for non-catastrophic losses and could require a separate deductible for declared catastrophic losses based on a percentage of the insured property value. For an additional premium, a policyholder could choose to purchase a lower catastrophe deductible. These policies would be available for homeowner's insurance, condominium owners insurance, renter's insurance, as well as for apartment building and condominium association policies.

To help consumers understand their coverage, a number of regulators supported including an easy-to-read checklist, similar to one being used in Florida (see Appendix V). Other regulators, and almost all industry representatives, disagreed with such inclusion noting that the insurance policy is a carefully worded contract that explicitly enumerates included and excluded coverages. Their fear is that a checklist could create additional contractual obligations. A majority of the working group decided not to include a checklist as part of the plan.

The Second Layer: Beginning the Public/Private Partnership at the State Level

State Catastrophe Funds and Limits of Responsibility

Each state is required to decide whether its exposures to natural catastrophes warrant the voluntary creation of a state catastrophe fund, participation in a regional catastrophe fund, or participation in a single or multi-state mechanism to collect funds from a national catastrophe backstop mechanism. Some states may determine that their private market does have the capability to provide the necessary coverages without an additional funding mechanism.

Participation in a State or Regional Catastrophe Fund Option

The funds would be responsible for creating and managing the insurance capacity of their respective jurisdictions. The fund would have discretion to create the actual operating structures of the fund to best fit their catastrophic risk exposures and insurance markets. The funds will be required to:

- Choose the appropriate financing mechanism.
- Choose the appropriate definition of a qualifying catastrophic loss event and trigger point (if any).
- Determine the appropriate retention amount between private insurers and the state fund and the participation by surplus lines companies and residual market mechanisms.
- Ensure that premiums for the chosen level of participation are actuarially sound.

H.R. 3355, as summarized earlier, contemplates such a voluntary state participation structure.

Mandatory Requirements of States

Regardless of whether a state determines there is a need for a fund, states should be required, by agreement or mandate, to finance mitigation education and implement programs that best meet the needs of its citizens. Under this scenario, all states would be required to:

- Use accepted engineering and science to establish effective building codes that properly reflect their catastrophic exposures.
- Develop high hazard land use plans where appropriate.
- Maintain a rigorous anti-fraud program to ensure that claims are attributable to an insured catastrophic loss.
- Establish and implement effective mitigation measures.

The Third Layer: The Role of a National Mechanism

Scope of Involvement

The final layer includes limited involvement by the federal government to assist in implementing a public/private risk pooling mechanism. The purpose of this layer would be to provide a mechanism for spreading the timing of catastrophic event insured losses. To that extent, the plan only considers insured losses.

The true costs of a catastrophic event should include losses outside the private insurance contract; the federal government will always be responsible for these losses based on its role in society. Though not specifically a part of this national catastrophic plan, federal sponsorship of low-cost loans and/or block grants for pre-event mitigation and post-event recovery should also be considered.

The National Catastrophe Insurance Mechanism

No other issue in the current debate has polarized the regulatory community, the industry, consumer groups, legislators and other parties as much as how to finance and insure against future catastrophic risks.

On one hand, many in the insurance and reinsurance industry aver there is sufficient capital capacity to meet the current demand for natural disaster insurance, and there is no need for public sector involvement. They suggest that any type of government intervention may have the unintended consequence of undermining the private market.

On the other hand, some experts suggest there could be a level of catastrophic natural disaster losses that are of sufficient magnitude to impair, if not implode, the private insurance market. These experts advocate a level of optional state or regional support, via catastrophe funds, and then a level of federal reinsurance back to these state or regional funds.

The debate is whether there is a sufficient ongoing supply of capital available in the private insurance/reinsurance market to provide coverage for natural disasters without significant market disruptions or failures. The answer to this question is complicated by the fact that the "size" of the market is not well defined and information needed to develop a reasonable answer has been difficult to acquire.

At the June 2006 meeting of the NAIC CIWG, reinsurance industry survey data was presented that demonstrated there was approximately $55 billion total capital available to support catastrophic risk, exclusive of individual insurer retentions. With the inclusion of primary insurer retentions, the estimated available capacity is about $95 billion globally.

Under the current system and types of coverage, it appears the industry has sufficient capital to support the current risks. However, there does appear to be disruptions in the flow of capital, and a number of insurers are reducing their writings for disaster coverage. If disaster insurance is modified based on the recommendations in the report, and the private market continues to write disaster risk, the "true" answer may be in the middle: some level of public involvement is needed.

To fully address these important issues, a national debate needs to occur that involves all stakeholders. Currently, Senate Bill 292 and House Bill 537 advocate the creation of a Natural Catastrophe Commission. The NAIC has adopted a resolution supporting the creation of such a Commission. Congress should establish this Federal Commission immediately, with an initial charge to complete an inventory of the disaster prone insurance markets in this country, and to establish the degree of required public support. In its analysis, the Commission's focus should be to determine reasonable levels of public support, and the appropriate form of that support.

The current debate focuses on the establishment of a "public trigger" or attachment points, and to make this point just short of private insurer bankruptcy. Given the dynamics of the market and the possible economic devastation combined with the imprecise calculation of this exact point, it would seem more prudent to find a reasonable level of public support.

If the Commission finds there is a need for a public/private partnership to insure against catastrophic natural disasters, the Commission should consider a layered approach similar to the NAIC's plan. The private markets would have the first layer of responsibility, while the state or regional mechanisms would represent the second layer. This layer would in turn be supported by the federal reinsurance at a level established by the findings of the Federal Commission.

An approach that utilizes a federal reinsurance program seems to be the most economical solution. An entity created by the Federal Commission would provide guaranteed lending or reinsurance to the state or regional funds. States without a fund would not be eligible for the program unless the state elected to participate in a manner established by the federal government. In return for the financing support, states would be obligated to adopt adequate disaster response and management mechanisms and enforce reasonable building code, land use, and mitigation efforts to minimize the amount of insured loss. As the federal reinsurance premiums would be risk based, the pricing mechanism must be used to encourage active development and enforcement of these standards. Losses beyond the federal reinsurance layer would, like now, be financed from the general Treasury and future taxing authority of the United States government. Again, as noted earlier, H.R. 3355 provides such a mechanism.

Other Considerations

The NAIC should continue to address perceived roadblocks within the U.S. Tax Code and within SEC regulations that are impediments to the private market's ability to fully utilize financial market structures to transfer catastrophic insurance risk from the insurance industry to other willing and informed investors.

The NAIC should expand its current review process to consider any changes to statutory accounting that, while still consistent with statutory accounting principles, may also encourage catastrophic risk transfer to the financial markets.

The NAIC should establish a best practices standard for its membership regarding disaster emergency response and planning.

Connecticut Perspective

Connecticut Perspective

Connecticut is a small and densely populated state, but represents the sixth largest state when it comes to overall coastal hurricane property value exposure. This ranks Connecticut behind only Florida, New York, Texas, Massachusetts and New Jersey. This presents us and many of our Northeastern neighbors with a large stake in this conversation.

Availability of coastal property insurance in Connecticut was problematic in the aftermath of Hurricane Katrina. In the past two years, however, there has been some stabilization. Rate pressure for coastal insurance has subsided, and rate increases have not been as dramatic. Moreover, there are three new writers in the voluntary coastal market, the program of a potential fourth writer is under review, and there continues to be interest in Connecticut's coastal markets. Anecdotally, reports from producers expressing problems in finding markets for their coastal clients have decreased.

Factors that are at work for the past two years include:

- Tight and diligent regulatory oversight of coastal property and homeowners rates for reasonableness and actuarial soundness, making maximum use of the Commissioner's authority to regulate for reasonableness under Connecticut's file and use rating statutes.
- New authority for Connecticut's FAIR Plan to write the named peril DP-2 dwelling property policy form.
- Restrained legislative response. Connecticut has not enacted a state wind pool or passed other reactive legislative provisions related to coastal insurance. The Connecticut Insurance Department has opposed legislative enactment of state sponsored/supported CAT funds. These proposals have never made it out of our legislative committee of cognizance.
- Slight softening in the property-casualty underwriting cycle.

As noted, Connecticut has not enacted a state wind or catastrophe pool. On a national basis, Connecticut is opposed to creation of state catastrophe funds backed up by the U.S. Government. Our opposition goes to all state or regional catastrophe funds unless they are fully secured and/or collateralized by the states where the funds and their risks are located. State funds, in and of themselves, are further problematic in that we are not sure a large scale wind event would be limited to a single state's borders.

Connecticut recognizes that a federal backstop for natural catastrophes along the lines of the Terrorism Risk Insurance Act ("TRIA") is appropriate provided the trigger is limited to the "mega-catastrophe" range so it would not displace the already functioning market. The market has been stressed at times, but has functioned while responding to seven of the top ten costliest natural catastrophes in U.S. history that have occurred since 2004.

It is important to emphasize the need for careful planning in catastrophe-prone areas and the need for limitations on coastal development. Mitigation efforts are critical to minimize the economic, human and environmental toll of catastrophes. The enlightened self interest of both the insurance industry and environmental organizations devoted to the preservation of wetlands, coastal zones and islands, as well as wildfire prone areas, have sometimes come into alignment on mitigation issues. There are good reasons not to develop fragile areas both from an environmental perspective, and for the protection of taxpayers and policyholders who will pay for the risk of coastal storms or wildfires. Even in catastrophe prone areas that are not environmentally sensitive, developers in those areas, and the purchasers of the property they develop, should not be allowed to develop or purchase property unless they fully understand and expect that they will pay for the risk, and that risk will not be passed along to the federal or state government. Development in high risk areas should be discouraged unless and until there is a financial recognition of the tenant risks (i.e. -those that chose to life there, pay the cost of the increased risk. The cost of this risk can not be transferred or "socialized" to those who chose not to live in these areas.)

We also want to endorse the need for strengthening building codes and pushing for mitigation techniques. As the White Paper notes, recent Florida hurricanes show that homes built or retrofitted to modern building codes are more likely to withstand catastrophic events, and an estimated 40 to 75% of the wind damage from Hurricane Katrina could have been avoided if homes had been built to modern building codes.

Connecticut is concerned about the notion in the Whitepaper that "some policyholders do have an expectation that their residential insurance policy will, net of a deductible, indemnify them in the event of damage to their home, regardless of the cause." That expectation, if true, is ill informed. A reading of a typical homeowners policy disclosures and a discussion with a knowledgeable producer would indicate that most policies exclude risks caused by floods and earthquakes, to name only the best known exclusions. Connecticut endorses language offered by South Carolina and Mississippi that more care should be taken by companies and agents to explain policy coverage completely to individuals whose risks are within catastrophe prone areas, and that policies should have easily recognized simple language showing policy coverage.

Louisiana Perspective

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Louisiana Perspective

Consistent with its guiding principles and three layer approach to risk-bearing capacity, *Natural Catastrophe Risk: Creating a Comprehensive National Plan* should include more detailed discussion of and proposals for (1) relieving the tax burden on reserves for catastrophes, (2) requiring state-sponsored entities to charge actuarially sound premiums to receive federal financial support; and (3) enabling private insurers to require flood insurance as a prerequisite to issuance of wind and hail insurance coverage. The guiding principles, unlike the well-developed discussion on layers of risk-bearing, require more explanation of why they are principles and how they guide the discussion.

Guiding Principles: The guiding principles are more effectively and efficiently stated as follows: (1) personal responsibility; (2) reasonable mitigation; (3) maximal private risk-bearing capacity; and (4) quantifiable federal risk management. Foremost is personal responsibility. The private citizen is the fundamental risk bearer and risk manager of the effects of any catastrophe regardless of insurance or government disaster relief. Government policies and programs should not create incentives that undermine responsible personal actions taken to mitigate and manage risk—sometimes referred to as moral hazard.

The principle of reasonable mitigation flows directly from personal responsibility. Responsible people take reasonable actions to protect their property from risk of loss or damage and to insure against such an occurrence. Insurers often assist and reward policyholders that mitigate risks. The responsibility to take reasonable mitigation steps increases when government funds share the risk of loss. Individuals and all levels of government should take all reasonable steps to mitigate losses from natural catastrophe.

Maximal use of private risk-bearing capacity builds on the first two guiding principles. Ours is a nation of private citizens holding private property. Private risk-bearing capacity best responds to private risks. Market opportunities and discipline offer incentives for the assumption and mitigation of risk. Properly functioning markets avoid the moral hazard of excessive risk taking by insurers and policyholders in contrast to public programs that do not properly price risk or that create the expectation of a rescue or bailout for those without adequate or any insurance.

Quantifiable federal risk management reinforces the first three guiding principles. It gives confidence to private markets and private citizens that the federal government will, among other things, stabilize the insurance system in time of catastrophe. That confidence affects insurance markets in a manner that people are encouraged to offer and to purchase insurance in a private, market-based system that rewards personal responsibility and reasonable mitigation of risks.

Tax Relief on Reserves Identified for Catastrophes: The whitepaper discusses tax-deferral[1] of insurance reserves identified for catastrophe losses. Under a tax-deferral regime, premium allocated to catastrophe reserves and any gains thereon would not be subject to tax in the tax year in which received, but they would be subject to tax when withdrawn. The short-term loss to the public is minimal compared to the long-term offsetting public benefit of solid private insurers with large pools of private capital readily available to satisfy claims and reduce the disaster recovery burdens of federal and state governments. [2]

There are technical issues that any plan would have to address—the creation of new reserves, the abuse of tax deferral, and the use of catastrophe reserves.[3] Without a limitation of tax deferral to new catastrophe reserves, insurers could merely shift

[1] Some discussions of this issue confuse the term “tax-deductible” with “tax-deferred.”

[2] U.S. Government Accountability Office, *Catastrophe Risk: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks*, GAO report GAO-05-199 (Washington: Feb. 2005), pp. 25, 29-31. (This report discusses “tax-deductible” reserves and not “tax-deferral.” The report expressed uncertainty regarding the cost-benefit analysis from a federal fiscal perspective. Since the release of the report, the Emergency Economic Stabilization Act of 2008 (PL 110-343 Sec. 706, 122 Stat. 3765, 3921, codified at 26 USC 165(h)) waived the adjusted gross income (AGI) limitation on casualty loss deductions for federally declared disasters and greatly increased the federal fiscal exposure to disaster casualty losses.)

[3] U.S. Government Accountability Office, *Catastrophe Risk: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks*, GAO report GAO-05-199(Washington: Feb. 2005), pp. 25, 29-31.

reserves into catastrophe accounts for the sole purpose of tax deferral without achieving the desired goal of increasing available reserves. On the other hand, without restricting the accumulation and deployment of tax-deferred reserves, insurers could retain gains and defer taxes indefinitely in a manner unacceptable from a revenue standpoint. The rules should also ensure that catastrophe reserves do not displace the traditional role of reinsurance in whole or in part for some insurers.[4] Such a market distortion would have the effect of replacing one risk-bearing capacity, reinsurance, with another, catastrophe reserves.

Pools of private capital accumulating without taxation under the watchful eyes of state insurance regulators would be a present and certain source of funds to pay claims after a disaster. Private capital would bring the added benefit of market-based pricing of risk. Market discipline compels insurers to adequately price policies and policyholders to take loss prevention measures thereby reducing the moral hazard sometimes associated with residual insurance markets or government guarantees. Tax deferral of catastrophe reserves promotes private markets and personal responsibility and strengthens the first layer of risk bearing—private capital.

Actuarially Sound Premiums to Obtain Federal Financial Backing: Any plan for the federal government to insure or otherwise guarantee the debt of state-sponsored entities that provide insurance for catastrophe loss should require the debt-issuing entity to charge actuarially sound premiums. Proper pricing of risk is essential to proper managing of risk. The premiums and other financing mechanisms (assessments, reinsurance, etc.) of state-sponsored risk pools and residual markets should be sufficient to manage risk based on "all reasonable factors that can be feasibly measured and supported by theoretical and empirical analysis."[5] Consistent with the three-layer approach, actuarially sound rates would "not create incentives for business to be placed in the residual market."[6] A quantifiable risk management program by the federal government requires reliable evaluation of its risk exposure. Federal support to state insurance entities should be based on a rational evaluation of financial risk and not an ad hoc response such as a financial bailout or rescue after the fact.

Requiring actuarially sound premiums promotes personal responsibility among policyholders who in response should rationally evaluate their risks before undertaking or mitigating them. Such a requirement also supports reasonable building codes, land use planning, and other mitigation tools, because policyholders, builders, and local authorities would have to consider the realistic cost of risk management in their decisions. Properly priced insurance by state-sponsored entities would also maximize the risk-bearing capacity of private markets by preventing unfair competition from under-priced state programs with federal financial backing.

Such a requirement supports the three-layer approach of private-state-federal financial capacity to address catastrophic losses. Requiring actuarially sound premiums gives substance to the reliance on private and state resources before turning to federal financial resources.

Flood Insurance as a Requirement for Wind and Hail Insurance: People want and need coverage that includes the entire risk associated with property ownership. Particular policies or riders for each type of risk can be inefficient and confusing. That leads to gaps in coverage that can be devastating to homeowners, neighborhoods, and communities trying to rebuild in the wake of a disaster and to a protracted resolution process with substantial litigation risk. After Hurricane Katrina, there

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U.S. Government Accountability Office, *Natural Disasters: Public Policy Options for Changing the Federal Role in Natural Catastrophe Insurance*, GAO report GAO-08-07 (Washington: Nov. 2007), pp. 41-2 and Fig. 4. (Report refers to "tax-deferred" reserves.)

Congressional Research Service, *Tax Deductions for Catastrophic Risk Insurance Reserves: Explanation and Economic Analysis*, Order Code RL33060 (Washington: Sept. 2005). (The report discusses "tax-deferred" and "tax-deductible" without distinguishing between them.)

[4] U.S. Government Accountability Office, *Natural Disasters: Public Policy Options for Changing the Federal Role in Natural Catastrophe Insurance*, GAO report GAO-08-07 (Washington: Nov. 2007), p. 42.

[5] *Natural Catastrophe Risk: Creating a Comprehensive National Plan* (Version 13), Appendix I Guiding Principles for Consideration of Federal Catastrophe Insurance, Guiding Principle 6.

[6] *Natural Catastrophe Risk: Creating a Comprehensive National Plan* (Version 13), Appendix I Guiding Principles for Consideration of Federal Catastrophe Insurance, Guiding Principle 7.

was litigation concerning the extent of coverage available to policyholders who did not have flood insurance. When a home is damaged or destroyed by multiple causes, it can be difficult to determine the extent of damage attributable to each risk. Insurers have an incentive to push the claim to other coverage or to a gap in coverage. Policyholders seek recovery from any available policies.

Federal law should require FEMA to provide timely cancellation notice to property and casualty insurers when requested on the maintenance of adequate flood insurance in the same manner as it does to lenders. This would enable those private insurers that want to require flood insurance as a prerequisite to wind and hail coverage to verify flood insurance as lenders are presently able to do.

Conclusion: Disasters large and small frequently occur in a country with the geography, population, and material wealth of the United States. The concentrations of people and wealth in areas prone to natural disaster compound the problems of relief and recovery, quickly overwhelming traditional reliance on local resources, public and private. In an interconnected society and economy, the effects of a catastrophic event can be disruptive nationally as well as locally. The tax-deferral of reserves, the requirement of actuarially sound premiums for state-sponsored entities, and the requirement of flood insurance cancellation notice from FEMA to wind and hail insurers are valuable elements of any national plan to address the disruptive effects of future natural catastrophes.

South Carolina & Mississippi Perspective

South Carolina/Mississippi Perspective

EDITOR'S NOTE: Director Scott Richardson (SC) and Commissioner Mike Chaney (MS) have provided the following edits to the paper as their suggested change. The underlined text is new and the overstrike text they recommend be deleted.

Introduction
Natural disasters take a heavy financial and emotional toll on Americans every year. Over fifty percent of the population in the United States lives within fifty miles of a coastline.

Following Hurricane Katrina, the Government Accountability Office (GAO) issued a report that concluded the United States is not well prepared to handle extreme natural disasters such as flooding, high category hurricanes, tornados and earthquakes; this includes the initial emergency response as well as the financial aftermath. Americans need to be better prepared for natural disasters both logistically and financially; insurance has an important role to play in this equation. NAIC favors an emphasis on "personal responsibility" and "private market" solutions over government solutions. NAIC does endorse a federal backstop for extreme catastrophic events.

The National Association of Insurance Commissioners (NAIC) has actively examined approaches to insuring against natural disasters for the last four decades. In fact, Volume 1 of the 1973 NAIC Proceedings cites a report from the Availability of Essential Insurance (D2) Subcommittee that recommends a five-step program to address this problem. Interestingly, step five is, "The Federal Government, in cooperation with the insurance industry and the NAIC, study and develop a mechanism that would provide additional capacity for catastrophe insurance and would allow for the accumulation of funds from which catastrophe losses could be paid without having those funds depleted by Federal income tax in loss-free years."

The Property and Casualty (C) Committee has developed a possible model system for implementing this concept of tax deferred catastrophe reserves, and has advocated legislative changes to the Federal Tax Law since 2000. More recently, the (C) Committee re-constituted the Catastrophe Reserve Subgroup to revisit the model system and to recommend possible changes. The NAIC feels it is imperative and prudent that Congress amend the Internal Revenue Code to encourage more private market catastrophe risk bearing.

The 1973 NAIC report also precipitated continued discussions of developing an additional security mechanism to insure against national catastrophes. In February 2005, the Catastrophe Insurance Working Group (CIWG) of the NAIC's Property Casualty (C) Committee held an interim meeting in Orlando, Florida to consider the US insurance industry's catastrophe readiness. More importantly, the committee also began to develop a comprehensive national plan to manage catastrophic risk, and utilized the guiding principles first established by the NAIC in 1999 (see Appendix I). The CIWG report summarized the work to date, and highlighted one important fact: a truly comprehensive solution will not only require a commitment of resources from the regulatory community and the insurance industry, but also from the federal, state and local governments.

Because of unbridled development, lax enforcement of flood maps , inconsistent building codes and inconsistent code enforcement through out the catastrophe prone areas in the country, and a host of other factors, it is unrealistic to expect the insurance industry to provide comprehensive catastrophe coverage to all comers without adequate financial backstops for the most extreme events. This report outlines steps that regulators believe must be taken to accomplish the dual purpose of providing a comprehensive plan that protects the public, while simultaneously providing assurances to the insurance industry should "an extreme catastrophic event" occur. Another issue is that even now, some of the nation's most exposed residential customers are experiencing difficulties with the availability and affordability of insurance products—future catastrophic losses may only exacerbate this problem. As would be expected, regulators and the insurance industry do not agree on how best to resolve these issues; these divergent viewpoints are noted throughout the report.

Background

There have been several recent natural disasters that have captured the nation's attention. The following examples highlight the estimated insured losses using 2007 dollars. In 1989, Hurricane Hugo caused $7.2 billion in insured losses to South Carolina. In 1992, Hurricane Andrew devastated Florida resulting in $23.56 billion in insured losses. In 1994 the Northridge Earthquake in California cost insurers a total of $17.9 billion. In 2004, four major hurricanes reached landfall in the Gulf Coast States which included Hurricane Charlie ($8.45 billion) followed by Ivan ($8.0 billion), Frances ($5.23 billion) and Jeanne ($4.17 billion). The most costly hurricane ever was Katrina in 2005 with insured loss estimates in excess of $50 billion. Two other hurricanes in 2005—Wilma and Rita—caused $7.64 billion and nearly $5 billion in damage respectively. It is not simply the frequency of large storms that created financial problems for the U.S. insurance industry --- all seven of these storms are now included in the list of top ten costliest storms in United States history.

With a few exceptions, all of the insured losses related to wind-damage have been handled by the insurance and reinsurance industries. This speaks well to the ability of the private market to handle most catastrophe events. However, proponents for government involvement point to the fact that some of the uninsured losses associated with these events have been paid by the states and the federal government using taxpayer funds. Despite relatively quiet storm seasons in 2006 and 2007, significant catastrophe losses appeared again in 2008. The potential consequences of extreme catastrophic events have public policymakers concerned about the industry's ability to continue to: (a) handle these catastrophic losses; and (b) have the capacity to handle an additional future natural disaster in the short term.

The Potential for a Mega-Disaster

While Hurricane Katrina was devastating, catastrophe modelers have identified a number of possible natural disasters that would dwarf the damages caused by this event. These are not fantastic scenarios, but instead, have already occurred in our nation's history – just not at current exposures, and structure values. The 1906 San Francisco earthquake would create damage of $400 billion with over $200 billion in uninsured property losses if it had occurred today; a repeat of the 1900 Galveston hurricane would cause $36 billion in possible damages; a repeat of the 1938 Category 3 hurricane that reached landfall in the Northeast would cause damage exceeding $300 billion; a repeat of the series of earthquakes that struck the New Madrid Fault in 1811 and 1812 would cause potential economic damage of up to $275 billion with insured losses reaching $100 billion. All of these scenarios have occurred in the past, and could potentially occur again in the future. The current structure to handle catastrophe losses may be overwhelmed by an event of this magnitude. . It is interesting to note that "catastrophe models" often have different projections for the same event, which emphasizes the need to allow insurers to use all of the scientifically valid tools at their disposal to evaluate the potential for risk. At the same time, to fulfill their obligation to ensure that insurer rates are neither inadequate nor excessive, regulators need to understand if catastrophe models are scientifically valid.

The Insurance Industry and Regulators Must Take Additional Measures

Many residential properties are overly exposed to natural disasters thus increasing the risk of damage. Whether it is through regional planning, mitigations measures, or more substantive building codes, cost-effective steps must be taken to reduce exposure to catastrophic losses. Insurers should provide incentives for consumers by providing risk appropriate credits for homes built to comply with effective building codes or for existing homes that are retrofitted to have a greater capacity to withstand damage.

Policymakers should also review how insurance benefits are delivered to the public. Despite the realities of wind pools, beach plans and the National Flood Insurance Program, there are some who believe that requiring a person to buy multiple insurance contracts to cover their homes and belongings clearly is not efficient, does not meet consumer needs, and often creates confusion during the claims settlement process. While Hurricane Katrina resulted in numerous disputes over whether a loss was caused by wind or water, most hurricanes do not result in this conundrum. When it does occur, however, determining whether a loss is due to wind or water is not just problematic, it is time-consuming and stressful to the public—especially if one peril is covered, and the other (often flood) is not. There have been several solutions examined on this issue, which, if adopted, will hopefully lessen the possibility of this being an issue in future events. Some policyholders simply want to buy one comprehensive policy that meets their needs. The insurance industry, along with the federal, state and local governments, should continue working with the regulatory community, needs to find a better way to meet these expectations.

Past Congressional Efforts to Address Catastrophe Losses

The United States Congress has considered many proposals to address catastrophic loss. In fact, since the early 1970s, only three Congresses (the 98th through the 100th—1983 to 1988) have failed to consider significant natural disaster legislation. Nevertheless, the only federal program currently in operation is the National Flood Insurance Program (NFIP), which is under Federal Emergency Management Agency (FEMA) jurisdiction. The GAO heavily criticized FEMA for its inadequate response to Hurricane Katrina, and the financial performance of the program has been checkered. The Homeland Security Secretary has taken a position in May 2009 against a federal multi peril program.

Several bills have already been introduced in the 111th Congress that would address catastrophe losses. Those bills are listed in Appendix I.

Alternative Solutions to Managing Catastrophic Risks outside the US

The US and other nations with developed economies have enacted a variety of programs to manage the economic consequences of catastrophic events. The programs differ in their structure based on underlying premises of the nature of the risk. Consequently the roles of the private insurance market and government entities vary considerably across programs. The GAO report "U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks," GAO-05-199 published in February 2005, provides a thorough description of these various approaches.

There is considerable public policy debate as to whether a specific type of natural catastrophe is an insurable risk. In 1968, the US Congress decided that flood was not an insurable risk, which resulted in the creation of the National Flood Insurance Program. Interestingly, other countries *do* consider flood an insurable risk. Indeed, both France and Spain have created risk pools that feature a state assumption of risk on an unlimited basis for specific natural catastrophes.

On the other hand, many natural catastrophes are considered insurable; government is used sparingly to supplement the private sector mechanism in these situations. Perhaps the most common tool available to the private sector in other countries is the ability to set aside reserves on a tax-deferred basis to pay for losses from a natural catastrophe. While differences do exist in how these reserves are structured and monitored, they are common throughout the world.

A recent International Accounting Standard ruling (accounting guidance that is followed by most of the rest of the world with the exception of the US) would have eliminated this reserving mechanism; however, virtually all European nations, along with a number of other jurisdictions chose not to adopt this new rule. The US does not currently allow insurers the option of establishing tax-deferred pre-event reserves to fund catastrophe losses; although a number of variants of a tax-deferred reserve have been developed since Hurricane Andrew in 1992. As mentioned before, the NAIC believes that on a priority basis Congress should consider steps to enhance private market catastrophe risk bearing, including appropriate tax code changes and a federal backstop program.

The creation of "risk pools" is another tool utilized to pay for catastrophic losses. Typically these pools are managed by the government, and funded by the private sector. As an example, in Switzerland coverage for all natural catastrophes, with the exception of earthquakes, is mandated in property insurance policies. Private insurers, as well as state-owned entities, pool these risks and determine an average actuarial rate. One caution should be noted; private carriers should not be forced to, participate in a system which under prices the exposure, or be the reinsurer of an underlying state program which is not financially sound up to a very significant attachment point.

Origins of the White Paper

In February 2005, the Catastrophe Insurance Working Group (CIWG) of the Property Casualty (C) Committee of the National Association of Insurance Commissioners (NAIC) met in Orlando to evaluate the state of catastrophe readiness in the US, and to initiate the development of a comprehensive national plan for managing catastrophic risk.

The Committee drafted a white paper, and presented this at the working group's meeting during the NAIC 2005 Spring National Meeting. Other regulators were given an opportunity to provide comments and feedback to the working group at this meeting. Based on this feedback, the working group decided it was appropriate to hold a half day mini-summit to hear from all interested parties at the following working group meeting in September 2005. Due to hurricane Katrina, the NAIC 2005 Fall National Meeting, as well as the mini-summit, was cancelled.

During the same time, a number of State Insurance Commissioners (notably commissioners from California, Florida, Illinois and New York) began work on a proposal that would help ensure a stable, long-term solution to the catastrophic risk problem. The state commissioners held a summit in November 2005 and offered a framework for this plan; a number of insurance and catastrophe experts were in attendance, provided information, and created a dialog on this important subject. The framework developed by the commissioners parallels many of the concepts developed by the CIWG.

The draft document has been revised numerous times to reflect consensus. On some issues, regulators could not achieve a consensus.

The current paper is based on several guiding principles:

- A national program should promote a solution through the maximum participation of the private markets.
- A national program should promote personal responsibility among policyholders.
- A national program should support reasonable building codes, land use development plans, and other mitigation tools.
- A national program should maximize the risk-bearing capacity of the private markets.
- A national program should provide quantifiable risk management by the federal government.
- A national program should provide a backstop similar to the terrorism program to manage risk that cannot be absorbed by the private market.

The current plan envisions risk bearing by private market insurance participants supplemented by optional state facilities before federal government resources are utilized. The Federal government would become financially involved through a backstop program if the catastrophic losses exceed the private market and state capacity.

Developing a Comprehensive Mitigation Program

Mitigation can produce profound benefits by reducing insured losses from a catastrophic event. Consumers should be educated about how specific mitigation efforts can increase property values and give consumers greater security in knowing their property is better protected to withstand the forces of nature. State and local governments, along with the insurance, construction, real estate and mortgage industries can be utilized to educate both current homeowners and prospective homebuyers.

Mitigation policies should provide property owners with meaningful mechanisms for effective mitigation measures. These mechanisms could include such things as low interest loans, grants and premium credits to upgrade existing properties, strengthen and enforce building codes for new properties, and to improve land use regulations in the development and redevelopment of communities located within hazard-prone areas. Policyholders should be further encouraged to invest in effective mitigation through a modification of the US Internal Revenue Code to allow federal income tax credits for investments that better protect property from natural disaster losses.

At the core of the proposed plan is the need for a comprehensive program to establish and implement effective mitigation and land use plans among the states. Clearly, this is not a "one-size fits all" endeavor; different natural catastrophes require different mitigation considerations. Therefore, the implementation of these standards is best reserved for state governments; mitigating for hurricanes in Florida requires a different set of techniques than mitigating for flood along the Mississippi or Platte Rivers. Other unique examples include insuring against tornadoes in Oklahoma, or earthquakes in Missouri.

The NFIP has determined that repetitive flood claims represent an inordinately high percentage of their overall claims. The NAIC believes that paying multiple claims on uninsured risks within Federal Flood Zones should not be allowed. This practice provides incentives for bad behavior and substantially weakens the ability of the program to pay losses to those who properly participate by paying premiums. The recent Florida and Texas hurricanes provided stark evidence that homes built or retrofitted to modern building codes withstand catastrophic events, while those built to lesser codes are more likely to structurally fail. Most recently, some media reports have suggested that 40 – 75% of the wind damage from hurricane Katrina could have been avoided if homes had been built to modern building codes.

Despite outreach by the Institute for Business and Home Safety (IBHS, www.DisasterSafety.org) and the Federal Alliance for Safe Homes (FLASH, www.Flash.org), one of the primary challenges facing a long-term solution is to incorporate this information into the economic decision-making processes. A competitive market requires an informed consumer and consumers need to be made aware of the options available to them when building or buying a home.

While efforts to make the benefits of mitigation clear in the insurance transaction are important, it is also critical to make the cost/benefit analysis part of the property owners' decision. Just as consumers now demand airbags and side-impact curtains in their automobiles, the ability to quantify the disaster resistance of a home should be integral to the decision making process. In one domestic example, a program in Oklahoma (see www.fema.gov/mitigationbp/brief.do?mitssId=843 for more information) has been promoting the benefits of having a safe room for shelter from tornados in Tulsa. This program has been quite successful; to the point where homes in the area without a safe room have become less marketable. Japan has an even more ambitious initiative that involves rating structures for earthquake resistance (see Appendix IV for an overview of the program).

More recently, Florida introduced a home grading and mitigation program for residential properties, the My Safe Florida Home program. At a CIWG meeting, representatives of the program presented an overview of the program to the working group. CIWG members agreed about the importance of a comprehensive mitigation program.

Creating Meaningful, Forward Looking Reserves

To further expand the capital base available for underwriting property risk, insurance companies should be allowed to set aside, on an objective formulaic basis, some portion of the premiums paid by the policyholders into a reserve for future catastrophic events. This ability will require a modification of the US Internal Revenue Code to allow insurers to establish these pre-event reserves on a tax-deferred basis.

Through the CIWG chaired by Florida, the NAIC developed a model plan in 2000. This plan is still pending, as it will take political initiative by the US Congress to amend the Internal Revenue Service Code. This year, Representative Thomas Rooney (R-FL) introduced the Policyholder Disaster Protection Act (H.R. 998). This bill offers amendments to the Tax Code that would allow insurers to voluntarily create pre-event reserves on a tax-deferred basis subject to a cap.

The bill shares many of the same features as the NAIC proposal. Reserves are calculated using a specific formula based on the amount of business an insurer writes in the lines of insurance potentially affected by a catastrophic event. This formula minimizes the opportunity for insurance companies to inflate reserves to defer federal taxes. When the cap is reached additional reserve contributions are fully taxed. Similarly, if an insurer leaves the business, the accumulated reserves are also fully taxed as income. Additionally, both Rep. Rooney's bill and the NAIC model plan have a 20-year phase-in period to accumulate maximum reserves. Unlike the NAIC proposal, the H.R. 988 trigger permitting the use of the reserves does not require an event to be officially declared a disaster.

The NAIC proposal is state specific with regard to the reserve calculation, while theRooney bill is based on an aggregate line of business calculation. The NAIC proposal has an aggregate industry dollar cap; H.R. 998 does not. Among the CIWG members and most industry interested parties, there was general but not unanimous agreement and support for the need to establish these types of reserves.

Enhancing the Insurance Contract

Policyholders are not generally sophisticated consumers of insurance products. However, policyholders do have an expectation that their residential insurance policy will, net of a deductible, indemnify them in the event of damage to their home, regardless of the cause. More care should be taken by companies and their agents to explain coverage completely to individuals whose risks are within catastrophe prone areas. Policies should have easily recognized simple language showing policy coverage. If policyholders understand that they have declined to purchase coverage that is available and understand the policy's exclusions, it will greatly reduce litigation and any misunderstanding about policy coverage.

During the development of the current NAIC plan, some members of the working group offered an alternative suggestion: offer a policy that provides coverage for all perils. There is a caveat to this "all perils" approach; specific risks would still be excluded including: ordinances or laws; power failures; property neglect; acts of war; nuclear hazards; intentional losses; and governmental actions. Thus, natural disaster coverage would be offered in the basic property insurance contract; regardless of whether it is financed by the private or public sector.

Under this concept, flood insurance would be included. The consumer would have only one insurance company and one claims adjuster in the event of a loss. However, the risk of flood would remain with the NFIP with the NFIP acting as a reinsurance program that would provide coverage to insurers for flood losses on a first dollar basis, minus the applicable deductible. Premiums for flood insurance coverage would be risk-based, and insurers would not be expected to subsidize flood insurance losses.

Other members of the working group, and most participating interested parties, were opposed to the mandatory all perils concept due to concerns about the reduction of consumer choice. Some regulators and industry representatives believed that including flood in the basic policy would create additional risks for the insurance company as the insurance companies would be required to pay the initial flood claims, and wait for reimbursement from the NFIP.

As a compromise, the working group agreed that to meet the expectations of consumers, the policyholder should be given a mandatory offer of an all-perils policy. If the consumer does not feel the need to insure against a specific risk at the price being offered by the insurer, the consumer can then decide which coverage(s) they wish to purchase and which they do not wish to purchase. Exclusions and coverage limitations should be disclosed and explained to the consumer prior to the purchase of the policy. Subtleties of whether flooding was caused by wind-driven water, storm surge or rain-induced flooding should be eliminated to alleviate any coverage confusion. Policyholders should also be required to acknowledge the impact of changes to coverage on the policies they purchase. At some point in the future, consideration may be given to changing the mandatory offer feature to a mandatory coverage of these perils.

However, the working group did feel that for those properties financed with a federally guaranteed mortgage (whether the guarantee is explicit or implicit), natural disaster coverage should be mandatory for those properties located in areas of moderate to high risk of catastrophic events. This may be expressed by the prevalence of the risk for a specific type of peril. For example, it could be mandatory for a 1 in 250 year flood event or earthquake event, or a 1 in 100 year catastrophic hurricane. Individuals with federally guaranteed mortgages are already receiving a sizeable subsidy from the US government, so it is fair to require these individuals to purchase adequate insurance. Ultimately, it is the American taxpayers who will pay for inadequate coverage of catastrophic natural disasters.

The policy could contain a fixed dollar deductible for non-catastrophic losses and could require a separate deductible for declared catastrophic losses based on a percentage of the insured property value. For an additional premium, a policyholder could choose to purchase a lower catastrophe deductible. These policies would be available for homeowner's insurance, condominium owners insurance, renter's insurance, as well as for apartment building and condominium association policies.

To help consumers understand their coverage, a number of regulators supported including an easy-to-read checklist, similar to one being used in Florida (a copy of the Florida checklist can be found at this link: http://www.floir.com/pdf/OIR-B1-1670.pdf) or Mississippi (a copy of the Mississippi checklist can be found at this link: http;//www.mid.state.ms.us). Other regulators, and almost all industry representatives, disagreed with such inclusion noting that the insurance policy is a carefully worded contract that explicitly enumerates included and excluded coverages. Their fear is that a checklist could create additional contractual obligations. A majority of the working group decided not to include a checklist as part of the plan.

Funding Catastrophe Losses

During the development of this paper, no issue has generated as much passion and controversy as the need for and the extent of government involvement in the funding of catastrophe losses.

On the one hand, some private market advocates assert that the private market is capable of handling natural catastrophe risk if it is permitted to charge rates that are adequate for the risk presented. Pointing to the surplus lines and reinsurance industries, some advocates state that even wind pools, beach plans and other residual markets would not be needed, or at least minimized, if insurers were able to charge risk appropriate rates. They suggest that such rate freedom will attract additional capital and competitors which will spread risk globally and across different pools of capital to the benefit of consumers and that competition will prevent excessive profits. These proponents claim the private market can adjust to growing demand, pointing to the historical record of increasing pools of insurance, reinsurance and reinsurance equivalent capital as evidence that the fundamentals of economics will address any demand and supply imbalances that may occur from time to time.

Private market advocates also state that consumers want to know the price of their insurance up front in the form of a fixed premium, rather than a combination of an upfront premium and post-event government taxes or assessments on their future insurance premiums to pay for the costs of the past catastrophic event. Further, they claim, consumers want to pay for their own risk and not be forced by the government to pay more to subsidize the riskier behavior of others who choose to live in more perilous areas. These advocates believe that government subsidies in property insurance inevitably lead to the creation of moral hazards which will increase the total cost of insurance

In addition, private market advocates claim that risk based pricing provides economic signals to consumers, developers and others that will reduce unwise development, provide incentives for home strengthening, and protect environmentally sensitive, but catastrophe prone areas. These supporters claim that government programs that interfere with risk based pricing will lead to the unintended consequences of increased development in harms way and a reduced incentive to strengthen existing buildings. On the issue of affordability, private market advocates suggest that transparent, needs based subsidies be employed as part of the government's social programs to address the social issue that some individuals may not be able to afford private insurance.

Advocates for differing levels of government involvement believe that affordability is an element that must be included. Further, they state that there are events that are too large for or are beyond the willingness of the private market to handle - or consumers to afford. In addition, referring to swings in the price of insurance and reinsurance after large events such as Hurricane Katrina, these advocates argue that government involvement will avoid price swings and shocks for consumers. As the private market price includes the risk of less likely, but still probable events (sometimes referred to as "tail risk") and a capital charge component, government advocates suggest that using the government to self-fund, over time for the less likely events, will lead to more available and affordable insurance at a lower price.

In addition, the government involvement proponents point to the portion of federal disaster payments that assist the uninsured. The proponents argue that since the government will be involved in any event, its involvement should be structured in advance to lead to a lower, stable price for insurance, the number of insureds will increase and the amount of government payments to the uninsured will be reduced. The opponents of government involvement dispute the implication that the bulk of federal disaster payments replicate homeowners' insurance payments. They note that most of federal disaster payments are for infrastructure repair, emergency housing (trailers), and cleanup – and, except for certain flood related losses, not for the payment of homeowner's insurance claims. .

Both sides point to Florida Hurricane Catastrophe Fund as evidence to support their position, either calling it a successful model for others to follow or a failed experiment that should be avoided.

Various solutions have been offered

The following sections contain a proposed public/private partnership involving state and federal involvement that has been included in the white paper over time. While not without controversy, the public/private partnership concept is being advocated by some in state and federal legislatures. In addition to the proposed federal legislation mentioned earlier, various entities have developed alternative solutions worthy of further examination. Summaries of many of these ideas that presented are set forth in Appendix V.

Beginning the Public/Private Partnership at the State Level

State Catastrophe Funds and Limits of Responsibility

Each state is required to decide whether its exposures to natural catastrophes warrant the voluntary creation of a state catastrophe fund, participation in a regional catastrophe fund, or participation in a single or multi-state mechanism to collect funds from a national catastrophe backstop mechanism. Some states may determine that their private market does have the capability to provide the necessary coverages without an additional funding mechanism.

Participation in a State or Regional Catastrophe Fund Option

The funds would be responsible for creating and managing the insurance capacity of their respective jurisdictions. The fund would have discretion to create the actual operating structures of the fund to best fit their catastrophic risk exposures and insurance markets. The funds will be required to:

- Choose the appropriate financing mechanism.
- Choose the appropriate definition of a qualifying catastrophic loss event and trigger point, which should be significant (i.e. 1/150 event probability), to maximize, supplement, and not displace the participation of the private market.
- Determine the appropriate retention amount between private insurers and the state fund and the participation by surplus lines companies and residual market mechanisms.
- Ensure that premiums for the chosen level of participation are actuarially sound.

H.R. 3355, as summarized earlier, contemplates such a voluntary state participation structure

Mandatory Requirements of States

Regardless of whether a state determines there is a need for a fund, states should be required, by agreement or mandate, to finance mitigation education and implement programs that best meet the needs of its citizens. Under this scenario, all states would be required to:

- Use accepted engineering and science to establish effective building codes that properly reflect their catastrophic exposures.
- Develop high hazard land use plans where appropriate.
- Maintain a rigorous anti-fraud program to ensure that claims are attributable to an insured catastrophic loss.
- Establish and implement effective mitigation measures.
- Identify state catastrophe prone zones, based on scientific evaluation, which will be used to establish areas where mandatory purchase of coverage for flood, wind, earthquake, etc is required to be eligible for participation in any applicable government subsidies or disaster assistance.

The Role of a National Mechanism

Scope of Involvement

The final layer includes limited involvement by the federal government to assist in implementing a public/private risk pooling mechanism. The purpose of this layer would be to provide a mechanism for spreading the timing of catastrophic event insured losses. To that extent, the plan only considers insured losses.

The true costs of a catastrophic event include losses outside the private insurance contract; the federal government has historically and will likely continue to be responsible for some of these losses based on the Stafford Act and its role in society. Though not specifically a part of this national catastrophic plan, federal sponsorship of low-cost loans and/or block grants for pre-event mitigation and post-event recovery should also be considered.

The National Catastrophe Insurance Mechanism

No other issue in the current debate has polarized the regulatory community, the industry, consumer groups, legislators and other parties as much as how to finance and insure against future extreme catastrophic risks.

On one hand, many in the insurance and reinsurance industry offer there is sufficient capital capacity to meet the current demand for natural disaster insurance, and there is no need for public sector involvement. They suggest that any type of government intervention may have the unintended consequence of undermining the private market.

On the other hand, some experts suggest there could be a level of catastrophic natural disaster losses that are of sufficient magnitude to impair, if not implode, the private insurance market. These experts advocate a level of optional state or regional support, via catastrophe funds, and then a level of federal reinsurance back to these state or regional funds.

The debate is whether there is a sufficient ongoing supply of capital available in the private insurance/reinsurance market to provide coverage for natural disasters without significant market disruptions or failures. The answer to this question is complicated by the fact that the "size" of the market is not well defined and information needed to develop a reasonable answer has been difficult to acquire.

At the June 2006 meeting of the NAIC CIWG, reinsurance industry survey data was presented that demonstrated there was approximately $55 billion total capital available to support catastrophic risk, exclusive of individual insurer retentions. With the inclusion of primary insurer retentions, the estimated available capacity is about $95 billion globally.

Under the current system and types of coverage, it appears the industry has sufficient capital to support the current risks. However, there does appear to be disruptions in the flow of capital, and a number of insurers are reducing their writings for disaster coverage. If disaster insurance is modified based on the recommendations in the report, and the private market continues to write disaster risk, the "true" answer may be in the middle: some level of public involvement is needed.

To fully address these important issues, a national debate needs to occur that involves all stakeholders, preferably through a congressionally appointed Natural Catastrophe Commission. The NAIC has adopted a resolution supporting the creation of such a Commission. Congress should establish this Federal Commission immediately, with an initial charge to complete an inventory of the disaster prone insurance markets in this country, and to establish the degree of required public support. In its analysis, the Commission's focus should be to determinelimited levels of public support, and the appropriate form of that support.

The current debate focuses on the establishment of a "public trigger" or attachment points, and to make this point just short of private insurer insolvency. Given the dynamics of the market and the possible economic devastation combined with the imprecise calculation of this exact point, some argue that it would be more prudent to find a level of public support that supports the stability the market after an event.

If the Commission finds there is a need for a public/private partnership to insure against extreme catastrophic natural disasters, the Commission may wish to consider a layered approach similar to the NAIC's plan. Under such a plan, the private markets would have the first layer of responsibility, while the state or regional mechanisms would represent the second layer. This layer would in turn be backed by federal support at a level established by the findings of the Federal Commission. Both the state and federal government involvement should be structured to complement, not replace or displace private markets.

An approach that utilizes a federal reinsurance, liquidity or loan guarantee program has been advocated by some as an economical solution. These advocates propose that a federal facility be created to provide guarantee lending or reinsurance to the state or regional funds. States would be eligible for the program only if they could show their rates were actuarially sound and their fund or program could withstand a 1/150 event for wind or 1/200 earthquake. Any loans should be based on a maximum payback period of 10 years in order to insure reasonably certain repayment by the state, and provide the state the reasonable ability to participate in future loans due to multiple events. .

In return for the financing support, states would be obligated to adopt adequate disaster response and management mechanisms and enforce reasonable building code, land use, and mitigation efforts to minimize the amount of insured loss. To participate, state facilities would be required to pay risk based premiums and the pricing mechanism must be used to encourage active development and enforcement of these standards. Any losses beyond the federal reinsurance layer would, like now, remain uninsured, with the private insurer, state facility or be financed from the general Treasury and future taxing authority of the United States government.

Such a federal program is controversial within the private industry and between regulators. No consensus on the need for or appropriateness of a federal reinsurance facility has been reached. Also, there is a concern that a greater federal role in catastrophe financing could lead to greater federal involvement in the regulation of insurance.

However, if a federal program is developed, it should require actuarially sound premiums, including a risk load in addition to funding for the average annual expected loss and related expenses, for the underlying insurance coverage and for coverage provided by any state or regional insurance or reinsurance facility. Such a risk load is needed to adequately reflect the full cost of the risk being underwritten.

Any national program should also abide by this paper's guiding principles:

- A national program should promote a solution through the maximum participation of the private markets.
- A national program should promote personal responsibility among policyholders.
- A national program should support reasonable building codes, land use development plans, and other mitigation tools.
- A national program should maximize the risk-bearing capacity of the private markets, and
- A national program should provide quantifiable risk management by the federal government.

Other Considerations

The NAIC should continue to address perceived roadblocks within the U.S. Internal Revenue Code and within SEC regulations that are impediments to the private market's ability to fully utilize financial market structures to transfer catastrophic insurance risk from the insurance industry to other willing and informed investors.

The NAIC should expand its current review process to consider any changes to statutory accounting that, while still consistent with statutory accounting principles, may also encourage catastrophic risk transfer to the financial markets.

The NAIC should establish a best practices standard for its membership regarding disaster emergency response and planning.

The NAIC should also seek to identify state legislative and regulatory impediments to increased private market competition and risk bearing, including restrictions on new or innovative risk financing products.

The NAIC should continue to support Congressional approval of tax deferred treatment of all "catastrophe related" premiums in order to build up reserve accounts in the private sector.

Appendix I –Guiding Principles

Guiding Principles for Consideration of Federal Catastrophe Insurance.
Adopted by
Catastrophe Insurance Working Group
of the Property and Casualty Insurance (C) Committee
May 21, 1999

1. Legislation should recognize the important role played by the states in insurance regulation with respect to such areas as licensing insurers, solvency surveillance, approving rates and forms, licensing agents, assisting consumers during the claim settlement process and performing market conduct examinations.

2. There should be a reasonable coordination and structuring of state and federal regulatory responsibilities with respect to a federal disaster insurance program that achieves the objectives of the program without unnecessarily compromising or preempting state regulatory authority and consumer protection. Necessary preemption of or limits on state regulatory authority should be compensated by requisite federal oversight. There also should be an appropriate balance of different private and public interests in the governance of and regulatory oversight over the program.

3. Legislation should recognize that many catastrophe exposures subject insurers to potential adverse selection as persons with less catastrophe risk are less likely to voluntarily purchase coverage, while those persons with greater risk are more likely to purchase coverage. If legislation were to create a government primary program, the program should encourage the inclusion of both low-risk and high-risk insureds to promote greater risk spreading in a way that does not subject individual risk-bearing entities to adverse selection.

4. Legislation should promote or encourage that coverage is available to any property that meets reasonable standards of insurability.

5. Legislation should supplement but not replace other private and public insurance mechanisms where those mechanisms can provide coverage more efficiently.

6. Rates for the catastrophe peril should be actuarially sound and should consider all reasonable factors that can be feasibly measured and supported by theoretical and empirical analysis.

7. State residual market mechanisms and other pooling mechanisms for property insurance should be allowed to participate in the entity established by legislation to provide catastrophe insurance, in such a way as to not create incentives for business to be placed in the residual market.

8. If a program includes provision of primary property insurance for catastrophe perils, voluntary market insurers should exclude coverage for the catastrophe perils from standard property policies and provide all catastrophe coverage through the program mechanism.

9. Legislation should encourage individuals to participate in the program or run the risk of losing access to federal disaster insurance.

10. If legislation designates certain states as "disaster prone" and makes provisions for those states, it should also address what happens if a disaster strikes in states not specified as "disaster prone."

11. For disasters that are seasonal in nature, any legislation creating primary coverage should encourage policyholders to maintain coverage throughout the year to stabilize premium flows and avoid adverse selection in terms of consumer decisions with respect to starting and ending coverage.

12. Jurisdiction over claim settlement practices should remain with the states.

13. Tax law changes should be encouraged to avoid penalties on and encourage the accumulation of reserves for catastrophe losses.

14. Legislation should encourage loss reduction and hazard mitigation efforts.

15. Legislation should encourage the strengthening and enforcement of building codes to reduce loss.

16. Legislation should not burden states with additional responsibilities without funding the mandated activities.

17. There should be coverage protection within reasonable limits for personal property policyholders in the event of the insolvency of the program or its participants.

18. Federal legislation should encourage the geographic spreading of risk.

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Appendix II – Catastrophe Legislation in the 111th Congress

111th Congress

Senate Bills related to Catastrophes and Insurance

- S. 505, The Homeowners Defense Act of 2009 would create a National Risk Consortium for the purpose of gathering data on catastrophic risk obligations held by state funds and facilitate the issuance of securities or other financial instruments related to funding of state catastrophe risks, and coordinating private reinsurance contracts between private parties and qualified state funds. It would also establish the National Homeowners' Insurance Stabilization Program to provide liquidity and catastrophic loans for qualified state and regional reinsurance programs.

  This bill is similar to H. 3355, The Homeowners Defense Act of 2007, which the NAIC endorsed as being consistent with the guiding principles established by the NAIC in 1999 (see Appendix II). The NAIC letter to Representative Ron Klein is attached as Appendix III)

- S. 886, The Catastrophe Obligation Guarantee Act of 2009 would establish a federal government program where it may enter into pre-established commitments to guarantee holders of debt issued by qualifying state programs, thereby making it easier for state programs to obtain post-loss catastrophe loss financing.

House Bills related to Catastrophes and Insurance

- H.R. 83, The Homeowners Insurance Protection Act of 2009 would establish a federal reinsurance backstop.

- H.R. 998, The Policyholder Disaster Protection Act of 2009 would allow insurers to establish tax-deferred catastrophe reserves.

- H.R. 1264, The Multiple Peril Act of 2009 would make windstorm coverage available in combination with the peril of flood or as a stand-alone policy through the National Flood Insurance Program.

Appendix III – NAIC Letter to Rep. Klein

November 6, 2007

The Honorable Ron Klein
313 Cannon House Building
Washington, DC 20515
The Honorable Timothy Mahoney
1541 Longworth House Building
Washington, DC 20515

RE: H.R. 3355, the Homeowner's Defense Act

Dear Congressmen Klein and Mahoney:

The NAIC congratulates you for putting forth legislation intended to help States better manage the threat of natural catastrophes. We appreciate your willingness to consider our perspective during the bill's development.

States have developed a variety of tools to fill insurance gaps in areas where the private market is either unwilling to provide property coverage, or where consumers are unable to afford it. Your legislation provides another tool for states to consider, without handing down a federal mandate to participate.

H.R. 3355 provides a strong correlation to guiding principles the NAIC adopted when evaluating federal catastrophe proposals. For example, the bill is voluntary; it does not impede state functions; it encourages availability; it recognizes the states' important role in insurance regulation; it forms a state/federal partnership approach to address availability; it follows actuarial principles; and, it allows states to pool risk and utilizes the capital markets.

The insurance and reinsurance markets have a significant amount of capacity, and access to that capacity for events that are small yet frequent is generally affordable. But for those that live in areas where events can be infrequent yet catastrophic, access to insurance capacity after a significant event is either unavailable or unaffordable. This is the dilemma that regulators and legislators must face together. H.R. 3355 provides a viable solution for the state and federal government to work together to address this dilemma and address the natural catastrophe threat. We encourage our members to strongly consider this program for their needs.

We thank you for your leadership on this critical, national issue, and we look forward to continuing to work with you to enhance the bill through passage.

Sincerely,

Walter Bell
Alabama Insurance Commissioner
NAIC President

Catherine J. Weatherford
NAIC Executive Vice President and CEO

Appendix IV – Japan Earthquake Rating Program

A more ambitious example of this kind of outreach can be found in Japan with respect to the earthquake exposure of residential properties. A public policy decision to make earthquake insurance (the program is actually for damage compensation; a form of insurance) widely available and used in Japan began in 1964 following the Niigata Earthquake. Today, in Japan there is a functioning public/private partnership between the Japanese property insurance industry, offering the policies, and the Japanese government, providing a form of reinsurance backstop. The system was revised in 1980 to further encourage participation by mandating that earthquake insurance be included on residential policies on a mandatory offer basis; although, the consumer may decline coverage.

The most recent revision to the earthquake insurance system came as a result of the Hyogoken-Nanbu earthquake (Kobe, Japan) in 1995, which resulted in 70,000 claims totaling over ¥70 billion (approx. $700 million US in 1995) and triggered the first government reinsurance program payout. In the aftermath of this earthquake the earthquake insurance program was modified to provide economic incentives to encourage the building of earthquake resistant residences. This was done by introducing discounted premium rates based on a building's earthquake resistance with discounts based on a housing performance indication system under Japan's Housing Quality Guarantee Law.

Under the current, voluntary system, premium rates for earthquake insurance are a function of the geographic region where the property is located, the construction of the residence, and the earthquake resistance grade identified above. Using data from 2004, for example, the base premium rates are determined by construction and location as:

Zone	Non-Wooden Structure	Wooden Structure
1	¥0.50	¥1.20
2	¥0.70	¥1.65
3	¥1.35	¥2.35
4	¥1.75	` ¥3.55

Note: *Rates are per ¥1,000 insured value.*

Based on the historical earthquake record in Japan, and resulting earthquake risk, the nation is divided into 4 zones. Base premium rates are then determined for each zone based upon whether or not the home is a wooden structure. As a result of changes in the building code implemented in 1980, an automatic 10% discount is given for homes built after 1981. Further discounts, ranging from 10 to 30%, are provided based on the type of earthquake resistance according to a 3-class system, defined in 2004 as:

- **Class 3** (sufficient earthquake resistance to prevent destruction or a collapse by a force 1.5 times the seismic force indicated in the Building Standards Law), **30%**;
- **Class 2 (**sufficient earthquake resistance to prevent destruction or a collapse by a force 1.25 times the seismic force indicated in the Building Standards Law), **20%**; and
- **Class 1** (sufficient earthquake resistance to prevent destruction or a collapse by the seismic force indicated in the Building Standards Law), **10%**.

There are significant differences between the US insurance contract and the Japanese earthquake system. Primarily, the focus of the Japanese system is not on indemnity, but rather on economic recovery; to that end, and much like the NFIP, the recoverable amount is capped on residential earthquake policies. Secondly, the Non-Life Insurance Rating Organization of Japan, not the competitive market, determines rates. Finally, the insurance covers property and contents, but does not provide for additional living expenses.

Appendix V – Florida Homeowners Policy Checklist

Checklist of Coverage

Policy Type: __________________

(Indicate: Homeowner's, Condominium Unit Owner's, Tenant's, Dwelling, or Mobile Home Owner's)

The following checklist is for informational purposes only. Florida law prohibits this checklist from changing any of the provisions of the insurance contract which is the subject of this checklist. Any endorsement regarding changes in types of coverage, exclusions, limitations, reductions, deductibles, coinsurance, renewal provisions, cancellation provisions, surcharges, or credits will be sent separately.

Reviewing this checklist together with your policy can help you gain a better understanding of your policy's actual coverages and limitations, and may even generate questions. By addressing any questions now, you will be more prepared later in the event of a claim. Experience has shown that many questions tend to arise regarding the coverage of attached or detached screened pool enclosures, screened porches, and other types of enclosures. Likewise, if your policy insures a condominium unit, questions may arise regarding the coverage of certain items, such as individual heating and air conditioning units; individual water heaters; floor, wall, and ceiling coverings; built-in cabinets and counter tops; appliances; window treatments and hardware; and electrical fixtures. A clear understanding of your policy's coverages and limitations will reduce confusion that may arise during claims settlement.

Please refer to the policy for details and any exceptions to the coverages listed in this checklist. All coverages are subject to the provisions and conditions of the policy and any endorsements. If you have questions regarding your policy, please contact your agent or company. Consumer assistance is available from the Department of Financial Services, Division of Consumer Services' Helpline at (800) 342-2762 or www.fldfs.com.

This form was adopted by the Florida Financial Services Commission.

Limit of Insurance: $________________ Loss Settlement Basis: _______________ (i.e.: Replacement Cost, Actual Cash Value, Stated Value, etc**Dwelling Structure Coverage (Place of Residence)** .)
Limit of Insurance: $________________ **Other Structures Coverage (Detached from Dwelling)** Loss Settlement Basis: _______________ (i.e.: Replacement Cost, Actual Cash Value, Stated Value, etc.)
Limit of Insurance: $________________ **Personal Property Coverage** Loss Settlement Basis: _______________ (i.e.: Replacement Cost, Actual Cash Value, Stated Value, etc.)
Annual Hurricane: _________________ All Perils (Other Than Hurricane): _________________ **Deductibles**

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Checklist of Coverage (continued) The above Limit of Insurance, Deductibles, and Loss Settlement Basis apply to the following perils insured against:(Items below marked **Y (Yes)** indicate coverage IS included, those marked **N (No)** indicate coverage is NOT included)

	Fire or Lightning
	Hurricane
	Flood (Including storm surge)
	Windstorm or Hail (other than hurricane)
	Explosion
	Riot or Civil Commotion
	Aircraft
	Vehicles
	Smoke
	Vandalism or Malicious Mischief
	Theft
	Falling Objects
	Weight of Ice, Snow or Sleet
	Accidental Discharge or Overflow of Water or Steam
	Sudden and Accidental Tearing Apart, Cracking , Burning or Bulging
	Freezing
	Sudden and Accidental Damage from Artificially Generated Electrical Current
	Volcanic Eruption
	Sinkhole
	Any Other Peril Not Specifically Excluded (dwelling and other structures only)

Special limits and loss settlement exceptions may apply to certain items. Refer to your policy for details.

Loss of Use Coverage			
Coverage		Limit of Insurance	Time Limit
(Items below marked Y (Yes) indicate coverage IS included, those marked N (No) indicate coverage is NOT included)			
	Additional Living Expense		
	Fair Rental Value		
	Civil Authority Prohibits Use		

Property -Additional/Other Coverages				
(Items below marked Y (Yes) indicate coverage IS included, those marked N (No) indicate coverage is NOT included)		Limit of Insurance	Amount of insurance is an additional amount of coverage or is included within the policy limit.	
			Included	Additional
	Debris Removal			
	Reasonable Repairs			
	Property Removed			
	Credit Card, Electronic Fund Transfer Card, or Access Device, Forgery and Counterfeit Money			

	Loss Assessment			
	Collapse			
	Glass or Safety Glazing Material			
	Landlord's Furnishings			
	Law and Ordinance			
	Grave Markers			
	Mold / Fungi			

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Checklist of Coverage (continued)

Discounts		
(Items below marked Y (Yes) indicate discount IS applied, those marked N (No) indicate discount is NOT applied)		Dollar ($) Amount of Discount
	Multiple Policy	
	Fire Alarm / Smoke Alarm / Burglar Alarm	
	Sprinkler	
	Windstorm Loss Reduction	
	Building Code Effectiveness Grading Schedule	
	Other	

Insurer May Insert Any Other Property Coverage Below			
(Items below marked Y (Yes) indicate coverage IS included, those marked N (No) indicate coverage is NOT included)		Limit of Insurance	Loss Settlement Basis: (i.e.: Replacement Cost, Actual Cash Value, Stated Value, etc.)

Personal Liability Coverage

Limit of Insurance: $_________________

Medical Payments to Others Coverage

Limit of Insurance: $_________________

Liability - Additional/Other Coverages				
(Items below marked Y (Yes) indicate coverage IS included, those marked N (No) indicate coverage is NOT included)		Limit of Insurance	Amount of insurance is an additional amount of coverage or is included within the policy limit.	
			Included	Additional
	Claim Expenses			
	First Aid Expenses			
	Damage to Property of Others			

	Loss Assessment			

Insurer May Insert Any Other Liability Coverage Below		
(Items below marked Y (Yes) indicate coverage IS included, those marked N (No) indicate coverage is NOT included)		Limit of Insurance

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Appendix VI – Various Other Catastrophe Funding Proposals

Protecting America (Protecting America.org; "Allstate Proposal")

Summary: Supports the creation of state catastrophe funds and a federal catastrophe reinsurance (backstop) fund. Qualifying state funds could purchase reinsurance through the federal fund.

Advocates a public-private partnership. States would create privately funded catastrophe reinsurance funds (currently only in place in Florida) intended to provide reinsurance at lower rates than available in the private reinsurance market. The funds would be financed through mandatory premiums paid by insurers in the state in an amount that reflects the catastrophe risk of the policies that they write in each state.

A portion of investment funds earned by the cat funds (a minimum of $10 million up to a maximum of 35 percent) would be used for mitigation, prevention, preparation and first responder programs in each state.

A federal natural catastrophe reinsurance fund would be created to provide additional coverage to state catastrophe funds, however a state could only purchase federal reinsurance if it had established the prevention and mitigation funding as described above. Rates for the federal coverage would be actuarially based and self-sufficient.

Gray Insurance Company Proposal

Summary: Federally regulated private insurance; Federal reinsurance; insurers offer all-perils coverage and act as distributors of federal relief funds.

Insurers would offer federally regulated all-risk homeowners and commercial property policies under the jurisdiction of the Treasury. Losses would be subject to a single deductible. Such policies would be exempt from state rating laws and would allow for enhanced underwriting and modeling capabilities.

Federally regulated insurance would result in all post-loss litigation issues decided by federal courts.

A single adjuster would handle claims, with company and independent consumer advocacy oversight.

Creates a Federal Disaster Relief Program (FDRP), to be enacted by Congress, to determine disaster relief based on pre-determined formulas. Disaster relief funds (including grants) would be distributed by the private insurance company at the time of loss.

Creates a Federal Catastrophe Insurance Pool (reinsurance) for private insurers; attachment point to be determined by company choice.

The Travelers - "Four Pillars"

Summary This plan proposes a private, market-based system, without federal subsidies for insurers, to address the problems of homeowners insurance availability that coastal consumers face today. The plan provides a framework to assist coastal residents in preparing to rebuild, repair and recover from the aftermath of named storm catastrophes. The Plan is based upon the following Four Principles:

1. A stable and consistent regulatory environment.

A uniform set of rules for insurers would apply with respect to named storm wind coverage for coastal states from Texas to Maine, allowing insurers to spread the cost of risk effectively among many people who are subject to the same risk. According to the Plan, uniform rules would promote stability and would encourage insurers to make long-term commitments of capital to those areas for wind risks, increasing the availability of insurance at efficient prices over time. An independent federal commission would establish these rules and oversee this narrow portion of the homeowners insurance market. The remainder would be subject to state regulation as it currently exists today.

2. Transparency in calculation of premium.

Insurance companies would individually and competitively set risk-based and actuarially sound rates using approved standards and certified windstorm risk models. The proposed Federal commission would certify models after reviewing and validating underlying model assumptions such as frequency, vulnerability and mitigation factors to ensure that rates are set in a transparent manner. In addition, the Plan calls for a rating calculation mechanism to generate prospective premium credits for customers if models and actual experience become misaligned over time to eliminate the possibility that insurers "win" and customers "lose."

3. Cost-based federal reinsurance mechanism with savings passed on to consumers.

To improve affordability and availability of insurance, a federal reinsurance mechanism would be created to provide coverage to insurers. Coverage could vary by zone to match the regional risk profile. Insurers would be charged actuarially-based rates. The plan does not propose an event trigger, but provides that the federal board would adjust reinsurance levels based on storm activity or market need. Public press materials indicate that such coverage would apply for events several times larger than hurricane Katrina

4. Mitigation against losses.

The Plan states that mitigation must be a centerpiece of any effective catastrophe insurance proposal, and there should be federal guidelines for strong building codes, incentives for state and local adoption and enforcement of those codes, enhanced construction technology, and land use planning requirements. In addition, the Plan endorses meaningful premium credits for mitigation and consideration of state and local property tax incentives for retrofitting houses.

<u>Coastal Catastrophe Partnership (Hartford)</u>

Summary: Calls for companies to charge risk-based rates. In states that have qualified to participate, companies retain losses for events up to a federal backstop and, where in place, up to a state backstop; state cat funds may be established to cover 1-50 to 1-100 year events; federal reinsurance would be offered to insurers and state residual market funds to cover losses above a 1-100 year event. States would have to meet specific criteria to qualify for federal reinsurance. Insurers would pass along the cost of the federal and any state reinsurance to policyholders. Policyholders in flood zones would be required to purchase flood insurance. A state subsidy mechanism may be created to help certain coastal insureds, and tax incentives would be established to help policyholders to share larger proportions of loss.

This plan is outlined as six core principles, calling for: disaster preparedness, land use planning and enforcement of building codes; rate regulation to allow risk-based rating; requiring state residual market plans to require risk based rating and adequate capitalization; a federal reinsurance backstop; reaffirmation of state-regulated policy language; and permitted state financial assistance for working families and retirees.

The plan calls for participation by coastal residents, insurers, state government and federal government – the 4 participants in the "Partnership."

Components of the plan are:

- States and local governments focus on building codes and land-use policies.
- Homeowners should be encouraged to accept a greater share in losses through higher deductibles and mitigation.
- Tax advantaged accounts should be permitted for homeowners to pre-fund losses; tax deductions or incentives should be permitted to offset mitigation costs.
- State may develop a subsidy mechanism to assist coastal homeowners.
- To avoid future disputes over wind v. water losses, homeowners located in flood zones would have to purchase flood insurance. As an alternative, the homeowners policy could include flood insurance at rates set by, and coverage reinsured by, the federal government
- State residual markets would continue to exist, but would have to charge risk-based rates and could not be competitive with the private market. Such plans would not rely on private industry assessments for funding.
- Insurers would be permitted to charge risk-based rates, enforce their contracts as intended, not be mandated to write business in any given market, and not be subject to excess profits provisions. If a state reinsurance fund exists,

insurers could retain losses up to, for example, a 1-50 year event. A federal backstop could start, for example, at a 1-100 year event

- State Cat Funds could be established to reinsure events between 1-50 to 1-100 years. Costs would be financed through premiums fully passed through and identified to policyholders.
- The plan does not call for, but suggests, that a federal liquidity program may be needed to respond with emergency debt relief to state Cat Funds or residual markets.
- A federal reinsurance backstop would provide reinsurance to insurers or state residual markets for events greater than 1-100 years. States would need to meet specific criteria to be eligible, including regulatory reforms allowance of risk-based rates, building codes and land use policies.

Nationwide Enhanced Homeowner Insurance Policy (EHIP)

Summary: Would create a voluntary federally regulated policy adding flood coverage. The Treasury would provide reinsurance for flood.

Insurers could voluntary offer a policy that includes flood coverage. The policy would be federally regulated and subject to market-based rating, except that flood coverage would be priced the same way as National Flood Insurance Program (NFIP) policies. Premiums for flood coverage would be placed into Treasury-approved bonds, and could accumulate tax –free.

The Treasury would provide reinsurance for flood losses that exceed funds in the flood premium account (or that reach a pre-determined percentage of accumulated funds). Insurers would pay for the reinsurance from the investment income of the flood premium funds.

The EHIP is intended to "tie-into" state wind pools or similar residual market mechanisms.

The Utah Catastrophe Insurance Plan

Summary: Utilizes the private market to provide all-perils coverage to primary residences. Premiums would be paid by the state, with revenue for premium payment collected by assessments on property taxes. Includes a series of high deductibles – the first borne by policyholders; the second by the state; and the third by the federal government. The federal government would play two roles – first by providing a backstop at four times the state's participation, and second by the subsidy resulting from a federal income tax exemption on the property taxes used to fund the plan.

The Utah Catastrophe Insurance Plan, proposed by Commissioner Michie, is aimed at protecting the state's taxpayer base by mandating coverage for catastrophes on all primary residential property while applying a series of large deductibles to lower the cost of the program.

The Plan would establish an administrative governmental agency, governed by a board of trustees. Qualifying private companies, selected by the administrator, would provide all-perils catastrophe insurance coverage to primary residential property. (While not specified in the proposal, presumably private companies would voluntarily seek to provide such coverage.)

In order for a private insurer to qualify for participation, the insurer must assume the primary coverage on the dwelling and must purchase reinsurance from a "qualifying reinsurance company." (The proposal does not address whether or not property owners may purchase coverage from non-qualifying companies, nor define "qualifying reinsurance company.")

The state would require all-perils catastrophe coverage on all primary residential property, although coverage would be subject to certain limitations on underwriting. (Examples of such imitations are not specified in the proposal.) Annual premiums would be paid by the state to the insurer. The state would generate revenue for the premiums via an assessment on annual property taxes, or some other appropriate taxpayer funding mechanism.

Cost of the all-perils catastrophe coverage would be reduced for property owners via a federal income tax deduction for costs added to property taxes, and by a series of large deductibles:

- The first deductible would be borne by the homeowner and would be set at approximately 10% of the property value;

- The second deductible would be paid by the state and would be fixed at a certain dollar amount (approximately $100 million or Utah); and
- The third deductible would be paid by the federal government and would be set at four times the state deductible.

The Plan anticipates a risk mitigation policy that may include a review of building codes, and/or a statewide survey of all building risks to establish a database upon which local building code administrators could rely for the purpose of managing and mitigating risk.

A national premium tax proposal to fund federal involvement

If there is to be a significant ongoing role for the federal government, the Congress should consider imposing a national premium tax on all property and casualty business in order to establish an insurance support fund. The insurance support fund would be used to fund: (a) loans to states; (b) needs based, financial subsidies to individuals; (c) and other federal natural catastrophe insurance programs.

Although controversial, this concept acknowledges that natural disasters have no bounds or limits on their destructive power. Any citizen in any state could be the victim of many different types of disaster.

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